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Background Paper 28

**VALUING HUMAN CAPITAL: TOWARDS
A CANADIAN HUMAN RESOURCE
INDUSTRY**

Joanne Harack Hayne, Norman
Pearson and Patrick Sweet

**Skill
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Leave Task
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**Background
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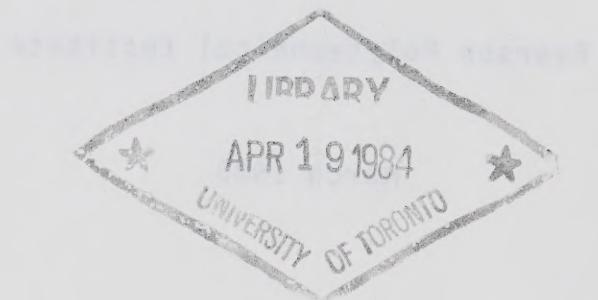
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Joanne Harack Hayne, Norman
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Ryerson Polytechnical Institute

March 1983

This is one in a series of background papers prepared for the Task Force on Skill Development Leave. The opinions expressed are those of the author(s) and do not necessarily reflect the views of the Task Force or the Department of Employment and Immigration.



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VALUING HUMAN CAPITAL:
TOWARDS A CANADIAN HUMAN RESOURCE INDUSTRY

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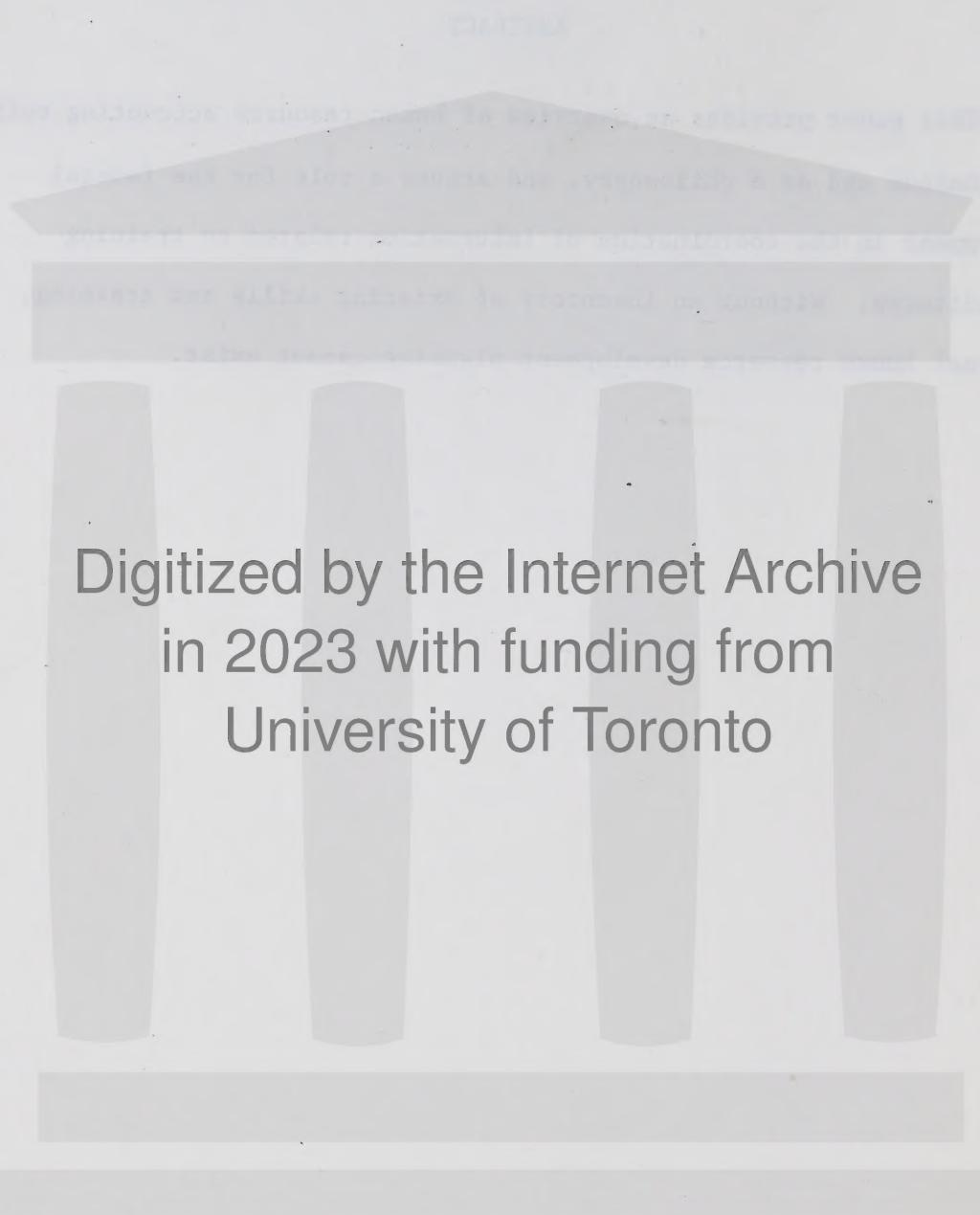
ABSTRACT

This paper provides an overview of human resource accounting both as a technique and as a philosophy, and argues a role for the federal government in the coordination of information related to training expenditures. Without an inventory of existing skills and training, national human resource development planning cannot exist.

With globalized industrial dynamics will come a labour force which can demonstrate its capacity for both increasing flexibility and improving accountability. At the present time, the Canadian economic landscape is characterized by growth, with markets more flexible, high unemployment and with short-terming, rapid technological development and change in competing alongside shifting globalization and limited labour market growth.

In such a climate, enhanced accountability requires that employees assume responsibility for the training and development of existing workers, without allowing them to the knowledge of the employer. This allows, in the end, for the rate of the growth of labour to meet the needs for particular kinds of jobs we are not immediately forthcoming as the will be no readily available resources resulting in recruiting of the services which are not immediately forthcoming.

It is therefore necessary to evaluate the existing labour market, which is done by examining which labour needs to be assessed and evaluated, and which may be more highly situated than the rest before it is determined



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I. INTRODUCTION

In a document accompanying the November 1981 budget, the Government of Canada stated:

Canadian economic development in the 1980's will be dominated by two realities: the continued development and expansion of the resource-based industries and the revitalization of industrial capacity towards specialized international competitiveness.

Economic Development for Canada in the 1980's

Such projected industrial dynamism will demand a labour force which can demonstrate the capacity for both increasing flexibility and improving productivity. At the present time, the Canadian economic landscape is characterized by paradox: skill shortages exist beside high unemployment and skill obsolescence; rapid technological development and change is occurring alongside falling productivity and limited labour market growth.

In such a climate, industrial adaptability requires that employers assign a high priority to the training and retraining of existing adult workers, rather than to the recruitment of new employees from abroad, or from amongst the ranks of the young. In order to meet the demand for new skills (many of which are as yet unspecified), particularly at the middle and high levels, continuous training and retraining of the current supply of workers will be a necessity.

An imperative to retrain the existing labour market supply in order to meet anticipated skill shortages should be examined realistically.

Canadians as a whole are more highly educated than ever before.¹ A labour

market development strategy which focuses upon proactive education of these citizens would appear to be dictated as much by common sense as by effective and efficient "human resources management" at the national level. Furthermore, there appears to be a growing public awareness of the relationship between education and work, an awareness which is likely to be compounded by technological change and economic uncertainty. Adult education research indicates that adult learners show a distinct preference for education which is vocationally and professionally oriented, with an emphasis on the application of knowledge.² Finally, the growing trend of mid-career change, which is a logical concomitant of contemporary demographic and socio-economic conditions, would suggest that the population is in a state of "learning readiness" for a national skill development policy.³

At present, the supply of providers of education and training for adults in Canada is extensive. A partial list includes boards of education, community colleges, universities, voluntary associations, private entrepreneurial organizations, professional bodies, industry, labour, government and the media.⁴ It could be argued that the network of opportunities for skill development in existence at present constitutes a decentralized but substantial service industry.

On the other hand, the multiplicity of suppliers of education and training reflects a variety of elements on the demand side: in particular, regional and industrial disparities, territorial concerns, and a tendency to focus upon micro rather than macro issues. In other words, the current training "system" is badly fragmented, and this should be of concern to policy makers insofar as it inhibits the development of a national response to international economic conditions.

Furthermore, it is extremely difficult to quantify the training which is actually taking place, particularly when that training occurs outside the formal educational institutions. The lack of a national data base, which is a factor with respect to Canadian education in general, is of particular concern with respect to adult education and training, because it compounds the problems of duplication of resources, inefficiency of service and inappropriateness of curriculum. Without accurate information about what currently exists, it is difficult to legislate or otherwise encourage increases or improvements in training programs.

Finally, it seems appropriate to emphasize that not all economic and industrial problems can be solved by increased training. Human capital is not the same as other forms of accumulated wealth, and training is by definition a human enterprise. Canadians have a great deal of experience in the management and development of human resources; however, our collective understanding of the nature of that experience, both quantitative and qualitative, is only beginning to emerge.

II. DEFINING "HUMAN RESOURCES"

One of the difficulties encountered at the outset when attempting to develop human resources policy, within any sector or at any level, involves vocabulary and syntax. The term "human resources" is a relatively new descriptor which varies in meaning from context to context. As the title of a recent textbook suggests, the term is often used synonymously with personnel.⁵ However, the "human resources" function is broader than the traditional "personnel" function, embracing the recruitment, hiring, training, development, management, and evaluation of staff, from junior to executive positions.

Depending upon the size, complexity and/or nature of the organization, these functions may be overseen either at a middle management or a senior executive level. The centrality of training within the general "human resources management" function depends to a large extent upon the nature of organizational goals and objectives; as does the degree of distinction between training and development of staff. (A sense of the range of "human resources" activity might best be conveyed by the observation that staff engaged in such work might, in Toronto, belong to the Personnel Association of Toronto, the Ontario Society for Training and Development, the Canadian Management Association, or all three.) The distinction between "education" and "training," which is slight in many respects, is nevertheless meaningful insofar as "education" is traditionally concerned with the development of the individual, whereas "training" relates primarily to the development of the organization.

Furthermore, it is possible to distinguish between "learning," which is fundamentally an individual activity, and "education," which is the system

whereby society organizes and encourages learning. Within this broad distinction, training undertaken by industry is clearly a part of the educational system.

Inherent in the semantic difficulties surrounding the field of "human resources" is a paradox. Training which fails to take into account the needs of the individual is ineffective; yet education which takes place without regard to the needs of society and its organizations is ultimately meaningless. One concomitant of the contemporary economic crisis appears to be a paradigm shift. The formal educational system is becoming increasingly aware of, and responsive to, the demands of the broader society, particularly in relation to the "bottom line" of cost effectiveness, while the workplace, as the plethora of "human resources" organizations suggests, is increasingly concerned with the needs of the individual.

Obviously, the role of government with respect to training must encompass both the individualist and the collectivist dimensions: it encourages the skill development of individuals, in aid of Canadian economic growth. The degree to which government can influence the direction of training within the private sector depends to a considerable degree upon its understanding of the nature and extent of current training practices. The scope of industrial training is not generally understood, and the development of human resources - people - is notoriously difficult to quantify. The conventional measurements of training in industry are imprecise because "training" expenditures are frequently unrecorded as such. There exists at present no generally accepted means of recording expenditures on human resources, or of relating them to corporate income, or to productivity. The lack of such basic data is one deterrent to the development of policy and incentives related to industrial training.

III. HUMAN RESOURCE ACCOUNTING

Human resource accounting, sometimes more broadly termed social responsibility accounting, is a method whereby expenses related to the development of human resources can be recorded. Since its first appearance in 1968, human resource accounting has been controversial, either because of fundamental measurement problems,⁶ or with respect to its underlying argument.⁷ In general, it is an attempt to translate the notion that people are corporate assets onto the balance sheet. Before considering the arguments for and against human resource accounting as a technique, it is useful to consider its philosophical base.

First, it must be emphasized that human resource accounting was originally conceived as an aid to management, rather than for use in published financial statements. Utilizing the terminology of conventional accounting, human resource accounting provides information of a financial nature concerning human resources development which is useful for long-range planning and for evaluating a firm's investment in its personnel. What the technique offers is not a new set of accounting principles and procedures, but rather a different way of considering expenditures related to people.

While it should be of pragmatic interest to those concerned with training and manpower development, human resource accounting derives from research into management style and organizational behaviour undertaken by the University of Michigan's Institute of Social Research. In the course of

investigating leadership styles, organizational psychologists observed that certain actions by management, particularly in the area of cost saving, could result in short-term increases in net profit when measured conventionally, but would result in long-term human resource losses.⁸

Such future losses would not be reflected in the financial statements of the year in which the decisions were taken, and hence the financial statement would not provide a meaningful or accurate measure of managerial performance:

If the accounting system provided measurements of the value of the firm's human resources and their changes over time, the "net income" (as conventionally defined) might be adjusted to reflect changes in the value of human resources, in order to avoid the illusion of reporting of "profits" derived from the liquidation of human resources. A net income figure adjusted for changes in the value of human resources would thus give a more realistic measurement of managerial effectiveness.

Specifically, human resource accounting was conceived as a method of providing information concerning the real cost of such phenomena as high staff turnover, and of relating such costs to managerial practice.

It is worth emphasizing that human resource accounting was construed as a means of bridging strictly financial and less quantifiable behavioural concerns. It was first espoused at a time when management theorists were discarding the old attitudes associated with "type X" management, with its emphasis on coercion, control, direction and punishment of employees, in favour of the new "type Y" management, with its emphasis on individual employee self-direction and commitment to corporate objectives.¹⁰ The interest in the human factors in organizations led naturally to an attempt to value those factors in financial terms:

Human Resource Accounting: the reporting and emphasis of the relevance of skilled and loyal employees in a firm's earning picture.

That human resource accounting could provide a more accurate assessment of training and development costs was seen as a useful, but essentially secondary, characteristic.

There are two basic approaches to human resource accounting. The first involves a direct human asset cost calculation, broken down into six components: recruiting, hiring, training, familiarization, experience and development. These costs are recorded either as capital expenses in the year in which a position is filled, or as assets if the benefits resulting from the expenditures are to be realized in a future period. Obviously, the advantage to a firm is that it can "amortize" certain training-related costs over a period of years, while at the same time retaining and developing existing skilled employees.

The second approach involves a "replacement cost calculation" which encourages a firm to estimate the dollar value of each employee in terms of the hypothetical cost of replacing him, or of replacing his position. This concept is somewhat problematic, though it does underscore the fact that the real cost of replacing a position is higher than a simple salary/benefit cost.

From the beginning, human resource accounting attracted stiff opposition from the accounting profession, since generally accepted accounting principles require that expenditures made in a given period be recorded as costs within that period. Consequently, companies employing human resource accounting have shown both the traditional accounting balance sheet, and supplementary statements showing combined financial and human resources. It appears

that the technique may be useful as an internal device within a firm: that is, senior management can more easily convince a departmental manager of the necessity of training his staff if he is allowed to balance the training-related expenditures against expected future departmental earnings.

There is little data available on the attitude of employees to human resource accounting, but one question which arises is whether human assets can properly be considered as such in conventional accounting terms.

Obviously, people are not "owned" by a firm in the same way that machines are "owned." On the other hand, the ownership of property entails certain corporate responsibility for maintenance which might be analogous to the responsibility for training and development of personnel; leases, for example, may be capitalized on a balance sheet as though they were "owned." Furthermore, salary scales and levels provide a rough valuation of the "worth" of positions and employees which is analogous to the valuation provided by a replacement cost calculation.

Perhaps the most serious criticism of human resource accounting was reported by Robert L. Woodruff, Jr., of the R. G. Barry Company, the first company to institutionalize human resource accounting, when he observed that a company might have the same dollar investment in two people, one of whom "could have a great deal more value in terms of what he was producing" than the other.¹² That is, the technique does not provide comparative measures of quality, nor of productivity. This is of particular concern for service economies, in which "productivity" is notoriously difficult to define, let alone measure.

Finally, one premise upon which human resource accounting rests is that expenditures on human resources lead to increased employee motivation, which in turn increases productivity. Although the data on this point is inconclusive, there is some evidence that high productivity increases motivation, rather than the other way around.¹³ Clearly, more research is needed concerning the relationships among training, motivation and productivity. However, it seems likely that the quality of the training may be more significant than the degree of training-related expense with respect to productivity improvement.

On balance, it seems unlikely that mandatory human resource accounting would serve a useful purpose. On the other hand, the increased disclosure of raw data related to human resource development - particularly with respect to training expenditures - seems desirable. The value of human resource accounting in this connection is that the "hidden" costs related to human resource development can be examined for comparative purposes. Without this raw data, human resource management is imprecise, and our assumptions about the relationship between training and job performance are unreliable.

IV. ISSUES WITH RESPECT TO VALUATION

The verb to value has two distinct but related meanings. The first, "to estimate the worth of, or appraise," informs human resource accounting as a technique. The second meaning, "to attach importance to, or hold in esteem," is reflected in human resource accounting as a philosophy. The notion of valuing human capital encompasses both meanings: that is, it implies both quantitative and qualitative concerns.

There is little doubt that modern information technologies will assist organizations in developing more accurate quantitative measurement of human resources. Greatly improved and generally accepted management information systems will allow managers to make internal assessments of turnover rates, absenteeism, training time and expenditures with a view to increasing profitability and/or productivity. In other words, "human resource accounting" will probably increase on the micro level, though it may be called something else. The ease with which such information can be accessed will greatly facilitate changes in management behaviour.

Furthermore, interest in and expectations concerning the entire socio-technical system - what has been termed the "quality of working life" - are increasing the pressures upon management at all levels to provide continuous learning opportunities for their employees.

Finally, we are passing into the era of a conserver society. This makes it more necessary than ever to develop to the full our human resources and so to learn to do more with less.¹⁴

Managers themselves will also require continuous updating in order to facilitate organizational change.

At the macro level, the measurement issues are more complex, and the qualitative issues more central. For example, should human resources be measured by sector, region, firm or occupation? How should attempts to increase flexibility, adaptability, technical currency and innovation be organized? What are the generic skills which facilitate these qualities within individuals, organizations and labour markets, and how are they defined and evaluated in a national context? Can a policy for human resources development at the macro level be separated from the issue of job design at the micro level?

In relation to all these issues, Canada has much to learn from the Japanese model:

The concept of continuous training in Japan plays a key role in minimizing resistance to change. Every employee keeps on training as a regular part of the job until he retires. This is in sharp contrast to the usual Western practice of training a person only when he has to acquire a new skill or move to a new position. Our training is promotion-focused; the Japanese training is performance-focused. The Japanese employee is trained not only in his job but in all the jobs at his job level, however low or high that level is. The concept of "continuous training" goes a long way toward preventing the extreme specialization and departmentalization plaguing North American business.¹⁵

Of course, Canada is different in fundamental ways from Japan; the wholesale adoption of Japan's methods would be neither possible nor desirable. Yet, if we are to develop industries which are competitive internationally, it is important at least to understand how other economies function. Many of the valuation issues have been addressed by other countries, and we can benefit from their experience.

Ultimately, of course, hard decisions have to be made with respect to human resources development in relation to other kinds of investment. For example, would funds allocated for skill development leave reduce funding available for job creation? Would research and development funding be reduced? How would the relevance of training to real labour market needs be evaluated? Most important of all, how can training be integrated with other aspects of economic development?

V. ROLES OF INDUSTRY, EDUCATION, GOVERNMENT

At present, the extent of industry involvement in training is considerable. Training activities range from the highly structured (e.g. formal in-company courses) to the relatively unstructured ("on the job" training). The trainers may be industry personnel, professional consultants, or instructors "rented" from educational institutions. Most industries have some involvement with post-secondary institutions; however, they express a general dissatisfaction with the degree of relevance to industry needs embodied in college and university curricula.¹⁶

Colleges and universities are involved in pre-employment training and, latterly, in continuing education of adult workers. A variety of factors combined have made it difficult for educational institutions to react quickly to changing labour market conditions; this is particularly true in technological subject areas, where both equipment and teacher shortages abound.

Government has a coordinating role with respect to both industry and education. It is also worth noting that all levels of government - federal, provincial and municipal - are heavily involved, as employers, in staff training and development. Government is also involved in establishing licensing requirements for certain professions.

Each of these sectors has its own strengths and weaknesses with respect to human resource development, and its own role to play, but it is clear that only government can provide the inventory of skills and training which is the necessary first step in planning a national human resource industry.

There are essentially three routes which human resource development can take: competition, parallelism and cooperation. Competition already exists within sectors (e.g. between institutions) and between sectors (e.g. between institutions and industry) in the provision of training. In the United States, various industries are involved in degree granting (the Wang Institute), and in Canada some industrial training programs are being marketed to the general public. One option might be to encourage such competition by freezing public funding for adult occupational training and letting market forces take over. This route does not appear to be promising, or even feasible.

Parallelism also can be said to exist, particularly between educational institutions and professional associations. Institutions have one set of requirements leading to certification, associations have another; each staffs its own courses, and they run along parallel tracks, without any essential competition. The encouragement of parallelism would involve funding for training designated for each sector. The drawback to this route is lack of coordination and inefficiency of skills development.

VI. SUMMARY: A NEW PARTNERSHIP

The third route, cooperation, is more difficult to encourage, but would appear to be the most cost-effective in the long run. It depends on the principle of adaptation and would involve the sharing of funding among sectors (for example, the "twinning" of institutions and industries within a community for training purposes). One key element in making this third route work would be assembling information about existing skills, training, needs and deficiencies on a regional basis. It appears that the regional level is an effective entity within which the federal and provincial governments, and those local educational bodies which are the creatures of the various provinces, can tackle an understandable segment of the problem of valuing human capital and survey, in a practical context, the state of the human resources industry in their area. Most private sector operations in industry, commerce, the service sector and in the unions, professions and associations of economic life are organized regionally. Canada's socio-economic life is understandable in terms of perhaps 60-80 functional regions, at various stages of development (such as the very obvious typology of metropolitan regions, regions focusing on large urban centres, rural development regions, regions mainly dedicated to natural resources development). Such an approach cuts laterally across the hierarchy of powers and responsibilities embodied in the constitutional relationships; but most of all, a regional structure fits the mind-set

of the Canadian people once they go beyond their identification with Canada or with major areas such as the Prairies or the Maritimes. Canadians live, work and operate within these discernible functional entities, many of which (such as the larger urban centres) already have some form of regional government and regional educational system directly related to regional universities, technical education facilities, and data banks. Governments at the senior level also have some regional structures. The socio-economic region makes sense culturally and already serves as a meeting place for all these interests. It is also the particular arena in which the problems inherent in competition and parallelism are most apparent. From such regional inventories, a basis might be laid both for regional cooperation, and for an accumulative or aggregative picture of such an inventory of skills, training, problems and potentialities, for the whole of Canada.

While such an approach takes time, the consequences could ultimately make for rapid progress in this field, on a lasting foundation.

Most Canadians live in a 200 mile band along the Canada-U.S.A. border. Most of the functional socio-economic regions in this band relate directly to comparable and almost parallel and competitive regions in the U.S.A. Canadian branch plants relate to their parent corporations in such regions, or to a comparably advanced region (such as Ontario's relationship to California with respect to high technology) elsewhere in the U.S.A. To avoid mere copying of what occurs in the U.S.A., a heightened consciousness of Canadian regional needs within an emerging natural inventory, would be a healthy development in focusing our providers, organizers and initiators

in human resources development as to workable solutions to the dilemmas posed by the existing routes of competition and parallelism.

Such an approach might result in more substantive agreement concerning the competencies required to meet real labour market needs than currently exists. It could enable the gradual emergence of reliable inventory data at the national level with respect to skills and training. It would permit a great variety of adaptive models to emerge, giving particular orientation to specific regional circumstances, while allowing us nationally to work towards some generic models and clearer principles than now exist.

There is an obvious need for diversity, flexibility and experimental adaptation. One answer which has been tried in countries such as Japan and France, is the large-scale "social engineering" approach, where problems are explored at the national level and then adapted locally within the national model. Such models appear to be applicable to unitary states, but in the various federal states they encounter problems of complexity, inadequacies of planning data, and differential regional needs because of the unequal stages of development in very large countries. In Canada we are always conscious that the bonds of confederation are the cement which makes the country work; but also that we are a country of diverse communities and regions both on a large scale and at the smaller socio-economic level.

The opposite approach to unified "social engineering" is the process of cooperative adaptation, going back to the principle that exchange of information and examination of the real problems of local and regional

communities (against a background of national identification of issues) is the starting point. We can then explore numerous tracks, and patiently work out in each area, mechanisms to meet the challenge. Then we can, as we so often do in Canada, build upwards again to various models which become the feedback from which new issues can be identified.

Canada has historically been a pioneer in various kinds of mutual aid and cooperation for national development. Examples are legion, from the village societies of old Quebec and Ontario, to the early unions, the prairie cooperatives, the beginnings of folk high schools, the Acadian self-help fishing and housing associations, and most recently the process of social animation. We have much relevant experience in this area.

Given the rapidly changing nature of our needs, and the prospect of virtually constant flux in our society, the cooperative model appears to be essential. It may enable a true human resource industry to emerge in Canada, and it may be a contribution we can make to the world.

NOTES

¹ In 1977, 32% of the labour force had "some" or a completed post-secondary qualification. By 1990, this number is projected to be 41%. G. Picot, The Changing Education Profile of Canadians, 1961-2000, Statistics Canada, March 1980.

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¹⁰ An extended discussion of "Theory X" and "Theory Y" can be found in Douglas McGregor, The Human Side of Enterprise, New York, 1960.

¹¹ Jerry M. Rosenberg, ed., Dictionary of Business and Management, New York, 1978.

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¹⁴ Eric Trist, "Adapting to a Changing World," a paper presented at the 6th International Personnel Conference, Montreal, November 1977.

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